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Cooperating Under the Iowa Cooperative Laws

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November, 1924

Circular No. 95

COOPERATING UNDER THE IOWA COOPERATIVE LAWS

**AGRICULTURAL EXPERIMENT STATION
IOWA STATE COLLEGE OF AGRICULTURE
AND MECHANIC ARTS**

**C. F. Curtiss, Director
AGRICULTURAL ECONOMICS AND
FARM MANAGEMENT SECTION**



AMES, IOWA

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SOME IOWA PAMPHLETS AND BULLETINS ON ARTICLES AND BY-LAWS

Suggestive articles of incorporation and by laws may be obtained from the Extension Service, Iowa State College, at Ames. A pamphlet issued by the Secretary of State also contains suggestive forms of articles of incorporation.

Other publications relating to Cooperation and Marketing issued by the Iowa Experiment Station or the Extension Service are as follows:

 Station Bulletin No. 200—Cooperative Live Stock Shipping in Iowa in 1920.

 Station Bulletin No. 209—Accounting Records for Live Stock Shipping Associations.

 Station Bulletin No. 211—Fifty Years of Farmers' Elevators in Iowa.

 Extension Bulletin No. 85—Organizing and Operating Cooperative Live Stock Shipping Associations.

 Extension Bulletin No. 125—Questions and Answers Regarding Cooperative Organizations.

 Extension Leaflet—The Board and Manager of the Cooperative Live Stock Shipping Association.

 Extension Leaflet—The Producer's Contract.

 Extension Leaflet—Report of the Appleton Live Stock Shipping Association.

COOPERATING UNDER THE IOWA COOPERATIVE LAWS

By FRANK ROBOTKA

It is estimated that since the passage of the 1915 cooperative law and the non-stock law of 1921, in the neighborhood of 500 Iowa farmers' organizations have been incorporated under one or the other of these laws. There still are a great many elevators, shipping associations, creameries and other farmers' organizations which are incorporated under the ordinary corporation law, as well as many that are not incorporated at all. In 1920, only one-third of the shipping associations were incorporated, and only one-fifth of them under the cooperative law. Over 200 of these have incorporated under the cooperative law since 1920. It was found that of the 511 farmers' elevators in Iowa in 1921, only one-third were incorporated under the cooperative law. However, as all of these have made the change since 1915, it is apparent that our farmers' associations are interested in adopting the form of organization which best enables them to carry out their purposes.

The object of this bulletin is to discuss the available Iowa legal forms in the light of their adaptability to the different purposes of farmers' organizations.

THE INCORPORATION OF COOPERATIVE ASSOCIATIONS

Farmers' associations organized for the purpose of engaging in business will ordinarily find it desirable to incorporate. The chief reasons are: The liability of the members of an incorporated company is limited; real estate and other property may be owned and transferred in the name of such a company; an incorporated company may sue and be sued in the name of the company; the property interest of the members is made definite and more easily transferable; the powers and privileges of a corporation are definitely prescribed in the law; the publicity required is a protection to the general public as well as to the members.

Farmers' organizations may be incorporated in Iowa under the ordinary corporation law; under the cooperative stock law of 1915; or under the cooperative non-stock law of 1921. The ordinary corporation laws were passed to meet the requirements of corporations organized for the purpose of profit-making. The desire of cooperators to place more emphasis upon service for members and less upon profit-making, resulted in the enactment of the 1915 cooperative law. Altho associations incorporated under it still retain, in modified form, most of the characteristic features of the ordinary profit-making corporation, the cooperators have a much better opportunity of carrying out their cooperative purposes under this law than under the ordinary corporation law. The 1921 law, however, represents a complete departure in many respects from the general corporation law. Under it, the "capitalistic" idea, with its stock and profit features and proxy voting are entirely eliminated.

THE PURPOSE OF THE ORGANIZATION

The answer to the question, "Under which law should we incorporate?" depends upon the purposes in the minds of the organizers. The purpose of the ordinary business organization is, of course, to engage in business

with the general public for the sake of earning profits for the proprietors of the business. When farmers establish cooperative business organizations, the purpose usually is not to make profits as business men dealing with the general public, but to make their farming operations more profitable. Broadly speaking, one or the other of two purposes seems to stand out in practically every such organization. The first purpose is: To establish a self-service organization for the members on a purely cooperative plan.

An organization having this purpose would, of course, transact business only for its members. It would be organized only when a group of farmers in a community, or in an entire industry, have need of mutual help in establishing some service vital to them as farmers. The motive would be to establish for the farming enterprises of the members a jointly administered sales department, or other department, to which they might delegate certain tasks which they cannot perform efficiently as individuals, or which are being performed by specialist middlemen. Cow test associations, threshing rings, bull associations and spray rings are familiar examples of simple local associations which are always built upon this idea.

The fruit associations in the south, west and northwest, the cranberry growers' associations, the cheese producers in the important districts, the nut, raisin and prune growers' associations, the egg and poultry associations of the west, the Danish bacon factories and dairy associations are examples of large scale associations built upon the same idea. In fact, practically all outstanding cooperative successes on a large scale are built upon this foundation.

The 1921 cooperative law is particularly adapted to the carrying out of this purpose, since it contemplates that business shall be done with members only, on the cooperative plan, and on the basis of the lowest practicable cost. This purpose might also be carried out under the 1915 law under favorable conditions, but this law has limitations in this respect and it is better adapted to the carrying out of the second purpose, which may be stated as follows: To establish a semi-cooperative, farmer controlled organization to do business on the competitive basis with non-members as well as with members.

Associations having the second purpose have had a wide development, particularly in the livestock and grain industries of the middlewest. Many of these associations have been organized in the early stages of the development of cooperative ideas and before cooperative laws had been enacted. No doubt, in many such cases the organizers may have had the first motive in mind, but because of local circumstances were forced to compromise, hoping, however, that in the course of time, their original purpose might be realized. In many communities a sufficient number of producers may not be willing or able to assume the individual responsibility to contribute their patronage exclusively to the association or to contribute to its maintenance whether they contributed their patronage or not. Furthermore, in some cases the community point of view may not be sufficiently well developed among the farmers to enable them to work harmoniously in a closely knit association. Under such conditions, if a farmers' organization is to be maintained in the market at all, it may be necessary, at least at the beginning, to depend upon non-members for an adequate volume of business. This would call for an association of the second type, which could be organized by a relatively small group of public spirited farmers who are willing to take the initiative. Such a venture, whether it fully accomplished all of the objectives or not, should at least demonstrate the advantages to be gained and blaze the trail for future development.

True as it may be that in many cases the second motive is adopted as a compromise or that it represents a transition period—a stage in the development of thoro-going cooperation—in other cases, it may be felt that the particular difficulty confronting a given group of farmers may

be effectively remedied merely by having the farmers represented in the market by an organization which is allied with agriculture and which would add "spice" to the competitive situation, even tho it might not be purely cooperative. A group of farmers may deliberately plan an organization in which most of the cooperative features may be incorporated, but in which the responsibility could be turned over to those who may be willing to assume it in return for the first claim to the earnings in the form of a limited dividend on stock. It may be mutually agreeable that the prospect of sharing in a patronage dividend should provide the inducement to attract the business of the members as well as much non-member business. In fact, the freedom which such an association may give to the community to "shop around" may be the deciding factor. The business men of the town as well as the farmers may recognize the benefits of such an association to the entire community and may be willing to lend it their moral and financial support.

Which of the two purposes discussed above should be decided upon in a particular case depends upon a large number of considerations which cannot be discussed here in detail. However, in the discussion which follows, an attempt is made to compare the two Iowa cooperative laws in the light of the distinctions between these two purposes and in the light of the usual devices employed by cooperators, such as controlling the membership, "democratic" control, distribution of earnings, sharing the privileges of the association, loyalty, producer's agreements, and sharing the financial burden. The essential differences are summarized in the table on page 5.

THE IOWA LAWS COMPARED

CONTROLLING THE MEMBERSHIP

Controlling the membership is usually considered of much importance in a cooperative association. Only if adequate means of control are provided can the membership be limited to those having a mutual interest. The history of cooperation is strewn with the wreckage of associations which fell because interests opposed to those of the original organizers have crept into the organization. A member of an association organized under the 1921 law cannot transfer his membership under any circumstances. Should he wish to withdraw, he would merely surrender his membership certificate to the association. No one else can, strictly speaking, take his place. New members may, of course, be admitted, but each case would be considered on its own individual merits. Furthermore, only those who have patronage to contribute will have any motive for becoming members of such an association, and the law specifically authorizes thus limiting the membership. Whenever a member ceases to have this motive, he will withdraw.

In a stock company, if a member ceases to be a producer or moves away, he may still desire to hold his stock for the sake of dividends, even tho they may be limited to 8 or 10 percent. In order that a similar measure of control might be maintained in such cases, it would be necessary that restrictions be placed upon stock transfers and that members who move away or cease to be producers be required to surrender their stock to the association. Such provisions are usually included in the by-laws by cooperative associations using the stock form of organization, and, in most cases, with fairly effective results. Membership may likewise be limited to producers by provisions in the by-laws at the time of organization. The 1915 law, however, carries no guarantee that changes will not be made in the by-laws in the future.

It will be apparent, therefore, that where control of the membership in the future as well as in the present is essential to the carrying out of the

ORDINARY PROFIT BUSINESS ORGANIZATIONS COMPARED WITH COOPERATIVE BUSINESS ORGANIZATIONS
Incorporated Under the Iowa Cooperative Laws of 1915 and of 1921

Features compared.	Ordinary profit business organization.	Cooperative business organization incorporated under 1915 cooperative law.	Cooperative business organization incorporated under 1921 cooperative law.
Nature and purpose of business organization.	An association of capitalists to exploit an opportunity to make profits by engaging in the production of goods, trading, or rendering service, depending upon its competitive strength to attract the patronage of the general public.	An association usually promoted by patrons, but not necessarily limited to them. The purpose is primarily to render service to member patrons, without obligating them as to patronage, but also depending upon its competitive strength to attract the patronage of the non-members in the community as well as of the members. The member-patron is usually the nucleus of the organization.	An association of patrons to render service to themselves at cost. Patronage is an obligation of the member. The purpose of such an association among farmers is to perform certain functions essential to agricultural production or the disposal of the products which the farmers desire to delegate to it, and for the performance of which it was organized.
Qualification of membership.	Capital contribution.	Capital contribution; other qualifications may be imposed.	Personally acceptable and must have need of service of association.
Relationship between members and patrons.	None; each is separate group.	None necessarily; limiting stock-ownership to producers only may keep non-producers out, but many non-members may be and usually are patrons.	Members and patrons are the same group; patronage obligations may be covered by marketing agreements.
Corporation membership; how transferred.	By transfer of stock certificate on books of company—usually no restrictions.	By transfer of stock certificate—sometimes under certain restrictions.	Not transferable; membership is personal privilege.
Basis of raising capital.	Proprietary capital raised on speculative and investment bases, profits or dividends being the inducement. Other funds raised on loan basis from banks and investment public.	Same as ordinary business organization except that need of service may be more important inducement than returns on capital.	Capital contribution by member is obligation in connection with the performance of the tasks delegated; the inducement is to accomplish the task rather than to receive large returns on the capital. Capital may be raised on loan basis from members, banks and general public.
Legal limit to stock ownership by member.	None.	\$5,000.	No shares of stock issued.

Basis of control and voting power.	Only capital contributors have voice, whether they participate in business or not. Vote according to number of shares and by proxy.	Only capital contributors have a voice whether they participate in the business or not. One vote per member, and proxy voting also permitted.	Personal participating membership is basis of control instead of capital contribution. One vote per member and no proxies.
Business risk — how borne.	By those who contribute proprietary capital.	By those who contribute proprietary capital.	By members as producers.
Benefits, how shared.	By stockholders only, as dividends on stock.	By stockholders thru limited dividend on stock; excess earnings shared by patrons on patronage basis.	Entirely by members according to patronage.
Rate of return on proprietary capital.	Not limited.	Not more than 10 percent.	No stock share capital; going rate of interest paid on borrowed capital.
Reserves required by law.	None ordinarily.	<ol style="list-style-type: none"> 1. Not less than 10 percent of earnings for reserve fund until same reaches 50 percent of paid up capital. 2. 5 percent of earnings for educational fund. 	<ol style="list-style-type: none"> 1. Not less than 10 percent of earnings for reserve fund until same reaches 40 percent of invested capital. 2. 1 percent to 5 percent for educational fund.
Patronage dividends.	None.	Earnings in excess of above reserves and dividends.	Earnings in excess of above reserves.
Method of establishing mutual relationship among a group of individual business organizations.	By means of trade associations, "agreements," pools, trusts, holding companies, combinations, often informal and secret; and often controlling production as well as selling, and other functions.	Local may invest its reserve fund up to 25 percent of its capital in the stock of another cooperative association; returns are distributed according to stock held; membership in central not limited to associations; method of voting not specified.	Federation of locals into central body, each local being represented by a delegate chosen by its board of directors, each delegate having one vote. Membership in central limited to associations formed under this law.

purposes of the association, the 1921 law has some advantages over the 1915 law. On the other hand, if absolute control by the producers is not essential, the 1915 law may have some advantages over the 1921 law.

"DEMOCRATIC" VS. CAPITALISTIC CONTROL

Since the motive of a purely cooperative association is not to go into business for profits, capital contributed cannot logically be the basis of the members' voting power. "Democratic" control has, therefore, been substituted for voting according to the number of shares held. Such "democratic" control has usually meant one vote per member and the elimination of proxy voting. Under the 1921 law, only those who are in a position to participate in the business will have any motive for becoming members. Hence, the voting power will be entirely in the hands of participating members. In a business concern operating for profit, those who furnish the patronage ordinarily have no voice in managing its affairs. They represent an outside group which may have nothing in common with the motives of the organizers. The control of associations incorporated under the 1915 cooperative law lies in the hands of the patron only if he is also a stockholder. But he has only one vote, regardless of the number of shares he may hold, and he has this vote whether he participates in the business or not. This method of control seems to give recognition to the presence of mixed motives in the association, as already discussed. Control by participating members is more completely attainable under the 1921 law, because the voting power is purely a personal privilege, and because absentee or non-participating members are automatically eliminated.

DISTRIBUTION OF BENEFITS

Sharing the Earnings. The table indicates the general methods of distributing the earnings under the different laws. Since the ordinary corporation is an association of capitalists whose motive is profit-making, any profits realized, of course, belong to them. Cooperative associations emphasize service to members rather than profit-making. Since under the 1921 law, no shares of stock would be sold, probably the most logical method of raising the capital is on the loan basis. In this case, the capital would probably receive the going rate of interest, and all excess earnings would, after deducting the required reserves, be distributed to the members prorata according to patronage. This method of distributing earnings is in accord with the purpose of associations organized to serve their members at cost. Such associations, can, of course, obtain approximately the same result under the 1915 stock law, provided that membership is limited to producers, that the stock is well distributed among those who contribute the patronage, and that dividends on stock are limited to approximately the going rate of interest. However, since the 1915 law does not require that these things be done, there is no guarantee that an adjustment of this sort will be made, or if made that it will be maintained in the future.

Since the law specifies only the minimum which shall be placed into the reserve funds, and the maximum rate of dividend on stock, it is optional with the association (1) whether it satisfies merely the minimum requirements regarding the reserves, pays less than the maximum of 10 per cent on the stock and pays out a relatively large amount in the form of patronage dividends; (2) whether it pays the full maximum of 10 percent on stock, and places all of the remaining earnings into the reserve fund, leaving nothing to be distributed as patronage dividends; or (3) whether it chooses a course anywhere between these two extremes. It is apparent that an association under this law may distribute as little or as much of

its earnings in the form of patronage dividends, within the legal limits mentioned, as the carrying out of its purposes may require. Because of this flexibility of the 1915 law, it is particularly adapted to the needs of associations having the second purpose.

The Corporation Surplus. Another feature of the profit-making purpose is the practice of building up a large corporate surplus or stockholders' interest. Next to receiving large dividends, the stockholder likes to see his interest in the business grow. Furthermore, it is no doubt sound corporation finance to build up a large surplus. To the extent to which this surplus exceeds a conservative buffer against adversity, the patron of an association which aims to be cooperative may object that too large a part of the proceeds from the sale of his product has been withheld from him for the benefit of the stockholder. Such an association obviously represents to that extent a combination of the profit-making and the cooperative ideas.

Since associations organized under the 1921 law have no stockholders, if a large surplus is built up it cannot be due to the motive of stockholders desiring to build up a large interest for themselves. Even though the members' capital contribution were made on a permanent basis, a large surplus could not be accumulated for their benefit without violating the intent and purpose of the law, which says that "the business shall be conducted on the basis of the lowest practicable cost."

Sound finance calls for the creating of reasonable reserves. This is provided for under both of the co-operative laws. In actual practice there may be little danger of excessive reserves being built up under either law. If the funds are needed in the business, patronage dividends may be applied on the purchase of shares of stock in associations under the 1915 law, or paid in the form of certificates of indebtedness in associations under the 1921 law. An advantage of the certificate of indebtedness is that it may be so issued that the holder will not retain a permanent interest. In the course of time the certificate will be paid and if so desired the burden shifted to those contributing the current patronage.

Sharing the Privileges. All of the benefits of a cooperative association, however, are not reflected in a distribution of earnings or savings. Even more important ones may be derived from the privileges of using its facilities and from savings distributed directly in the form of prices paid or proceeds of sales prorated.

If cooperation means mutual sharing of burdens and benefits, obviously the privileges of using a cooperative association would be limited to the members only. This is what cooperation means to the cooperators in the case of most of the outstanding cooperative achievements on a large scale in this and other countries. This is the purpose embodied in the 1921 cooperative law, which says that business shall be transacted with members only. In this respect the law guarantees that the facilities established by the members for their own use will not be exploited by those who did not see fit to help establish them.

The 1915 law, however, carries no such guaranty. This law is better adapted to the purposes of associations whose object is not to restrict the use of their facilities to members, but rather to cater to both members and non-members alike. To be sure, the organizers of such an association may feel that the services of a purely cooperative association should be available only to members, but because of local circumstances they may be forced to adopt the other policy. That this is frequently the situation, seems to be borne out by the fact that there usually develops in such associations the feeling on the part of the members that non-members who patronize the association are accepting favors,—that something is being done for

them for which they are returning nothing. There is a feeling that they are morally bound to assume the responsibilities of membership. Without stopping to discuss the question of moral obligation, the fact remains that as long as the form of organization permits such non-members to receive the benefits without assuming the obligations, many if not most of them are likely to continue to do so. Whether the original organizers were forced to compromise, or whether the purpose was to mix the cooperative and profit-making motives, the cases are the same in that the immediate purpose is to do business with both members and non-members. The business of non-members is, in fact, usually as welcome to such associations as member business. Not only is the non-member accommodated, but his patronage helps reduce the costs of operation; it improves the prospect of regular dividends on stock being paid; it helps build up a surplus, and makes possible the rendering of more efficient service.

There is, however, another side to this question which should be considered, where the purpose of the association is to use the producers' contract. The courts have held that associations which do business with non-members cannot enforce marketing contracts with their members. This practice, at least from the legal point of view, destroys the basis of obligation of the members to each other. Since such associations are presumed to have recourse to the business of non-members, it is held that they cannot suffer recoverable damages when a member takes his patronage elsewhere. This leads to the question of membership responsibility.

SHARING THE RESPONSIBILITIES

Loyalty. In addition to democratic control and sharing of benefits, we hear much about the responsibilities of members and loyalty in connection with cooperative organizations. The producers' contract has lately received a great deal of attention in this connection. It has already been suggested that a different relationship existed among the members of a cooperative association from that among the members of an ordinary commercial concern. In a business concern organized for profit-making, the responsibilities of the members are financial. As a shareholder, the member's chief obligation to the company is to pay in the par value of the shares he holds. Since the purpose is to make profits from dealing with the general public, the patronage of the members is not depended upon; they may, in fact, have none to contribute.

However, if the motive of a group of people is to set up an organization for the purpose of performing certain tasks that they have decided to delegate to it to perform, the organization has an excuse for existing only so long as the members continue to want to delegate such tasks to it. Such a group will, therefore, assume the responsibilities of establishing the organization and such financial risks as this may involve, only on the strength of the fact that there is found within the group a sufficient volume of business to warrant its doing so. In consideration of the mutual advantages to be gained, the members would assume mutual obligations. In other words, they would enter into a business arrangement among themselves to do or not to do certain things. The failure of any one of such members to fulfill his obligations would, therefore, result in damage to each of the other members. In this case it is hardly a question of voluntary loyalty, but of definite obligation, because a definite business arrangement is contemplated.

Important business arrangements are usually covered by written contract, not that the obligation is thereby made more real, but because it is customarily regarded as "good business", with all that the term implies. Likewise, good business may dictate that in a cooperative organization certain obligations be covered by written contracts or producers'

agreements. The cooperative law of 1921 recognizes this legitimate use of the producers' agreement and specifically authorizes its use.

However, if a group of people decide to establish a business organization for the purpose of engaging in business with the general public, as well as for the purpose of improving the market for their own products, there really exists no such mutual obligation among them. Such a venture must depend largely upon its competitive strength to attract the business of the community. It may adopt the patronage dividend plan and limit the dividends on stock as inducements to non-members as well as members, but even the member may feel that the organization is fulfilling its purpose by merely improving the competitive situation, or by giving him an additional alternative outlet for his products, which it may accomplish whether he contributes his patronage exclusively to it or not. To be sure, it may be poor business for those who have contributed the capital to take their patronage elsewhere, but the motive of such a group is distinctly different from that of the group referred to in the preceding case. The loyalty of the producers in the community may be appealed to on the ground that the organization is of benefit to the community and that it can function efficiently, if at all, only if most of the producers contribute their patronage to it. However, mutual obligations exist only where the motive on the part of a group of individuals is definitely to establish such mutual obligations in order to obtain mutual advantages.

The 1915 law is particularly adapted to cases where the motives are such as have been described in this case. The use of the producers' agreement in associations incorporated under the 1915 law is of doubtful validity, since such associations are not required to limit their business to members only, and seldom if ever do so. Moreover, the motive of such an association does not contemplate limiting the business to members only.

The question of loyalty and the producers' agreement is discussed further in an Extension Service leaflet, "The Producers' Contract."

Sharing the Financial Burden. Distributing the responsibility of financing a cooperative association seems always to have been a problem. The ideal of distributing it according to benefits received seems seldom to have been fully realized. As nearly as this is usually approached under the stock plan is to secure a wide distribution of the stock in the community and to apply patronage dividends on the purchase of shares of stock. No convenient means is provided, however, for re-apportioning the original shares among those using the association, as the patronage shifts in the course of time. Too frequently the directors are forced to assume personal liability for borrowed funds, and at best the burden rests with undue weight upon a limited number of public spirited men who realize the benefits of the association to the community. The non-stock association has many advantages in this respect, which will be discussed in connection with the following explanation of methods of financing such associations.

FINANCING NON-STOCK ASSOCIATIONS

There is nothing mysterious about the financing of non-stock associations. All of the methods available to stock associations are available to non-stock associations, except the sale of shares of capital stock. Funds may still and should be obtained from the members, but as an obligation in connection with the performance of the task delegated rather than for the sake of dividends. Instead of a certificate of stock, which promises nothing specific regarding interest payments or repayment of the investment, there may be issued to the member a special type of note, called a certificate of indebtedness. This is issued "for value received," and

would bear a reasonable rate of interest. The note may run indefinitely or be subject to repayment according to some definite plan.

The amount to be loaned by each member may be uniform or according to availability of funds, or it may be based upon the use made of the association by each member. Both of these methods may be used—the first in raising the original capital and the second as a gradual shift can be made to it. This shift may be made in two ways: 1. by re-apportioning the loans according to patronage every three or five years; 2. by the revolving fund method. The latter method accomplishes the purpose more or less automatically and, because of this convenience, is to be preferred.

THE REVOLVING FUND

If the certificates are to run indefinitely or are to be re-apportioned at the end of a given period, no provision for repayment need be made. A periodical readjustment, however, makes it possible to increase or decrease the capital needed and to equalize the financial burden of new members as well as old members.

However, if the certificates are to be redeemed, an assessment will need to be made against each unit of commodity handled. The amount of the assessment will depend upon the amount of certificates to be liquidated each year and upon the volume of business done. As it will ordinarily be difficult to forecast what the volume of business will be for the year, the certificates may be made payable in rotation, according to serial number. Such funds as the assessment yields in a given year will then be applied as far as they will go in liquidating the certificates.

These assessments represent new loans made by the members to the association and new certificates will be issued to the members at the end of the year as evidence of such loans. Eventually, all of the original certificates will be paid and new certificates in the same amount will be outstanding. As the assessments continue, these new certificates will in turn be liquidated. Thus the process will continue. The effect is to shift the original loan from the original lenders to those contributing the current patronage and in proportion to the patronage contributed by each member.

If part of the original loan is obtained at the bank or from other outside parties, the procedure will be the same—the first assessments merely being applied first on such outside loans. Security for such loans may consist of a company note backed by the property financed from members' capital, or members' collateral notes may be used.

For the purpose of illustration, assume that an association started business with \$9,000 contributed by the members and \$9,000 borrowed at a bank. Also assume the assessment to be one cent per unit of business done. The following table shows the annual result of several years' operations:

	Volume of business—units	Original loans				New certificates issued to members covering assessments	
		Bank		Members		Issued	Paid
		Bor- rowed	Paid	Certificates Issued	Certificates Paid		
Original amount ..		\$ 9,000		\$ 9,000			
End of 1st year...	300,000		\$ 3,000			3,000	
End of 2nd year...	400,000		4,000			4,000	
End of 3rd year...	200,000		2,000			2,000	
End of 4th year...	500,000				\$ 5,000	5,000	
End of 5th year...	400,000				4,000	4,000	
End of 6th year...	400,000					4,000	4,000
Total	2,200,000	\$ 9,000	\$ 9,000	\$ 9,000	\$ 9,000	22,000	4,000

During the six years, 2,200,000 units were handled, yielding \$22,000 at the assessment rate of one cent per unit, for which new certificates had been issued. This amount was applied as follows: \$9,000 to repay the loan at the bank, \$9,000 to liquidate the original loan from the members and \$4,000 of the new certificates. There still remains outstanding an indebtedness of \$18,000, but it has all been shifted to the members on the basis of patronage.

The following illustration compares the effect of these assessments upon two patrons contributing different volumes of patronage over a period of years:

	Patron A.			Patron B.		
	Volume of business —units	Certificates		Volume of business —units	Certificates	
		Issued	Repaid		Issued	Repaid
Original certificates -----		\$ 100			\$ 50	
End of 1st year -----	10,000	100		2,000	20	
End of 2nd year -----	8,000	80		4,000	40	
End of 3rd year -----	5,000	50		6,000	60	
End of 4th year -----	2,000	20		8,000	80	
End of 5th year -----			\$ 100	10,000	100	\$ 50
End of 6th year -----			100	12,000	120	20
End of 7th year -----			80	12,000	120	40
End of 8th year -----			50	10,000	100	60
End of 9th year -----			20	10,000	100	80
Total -----	25,000	\$ 350	\$ 350	74,000	\$ 700	\$ 250

It will be seen that A's patronage continued to decrease and finally ceased altogether, while B's increased. A's assessments ceased with his patronage, while B's assessments increased with his patronage. At the end of the fifth year the first certificates issued to both patrons were repaid and each year thereafter the oldest outstanding certificates were paid. At the end of the ninth year A has ceased to have a financial interest, while B still holds \$540 in certificates.

The financial interest of retiring members is thus automatically liquidated, and the burden is redistributed among the new members as well as among the older members who continue to contribute patronage in varying amounts.

LARGE SCALE COOPERATIVE ASSOCIATIONS

The discussion thus far has had to do specifically with the local association organized for the purpose of handling purely local problems. However, Iowa has many marketing problems which are common to the whole of Iowa or to particular parts of Iowa, and which can be solved effectively only by larger business units.

As the same fundamental principles underlie large scale cooperatives as local cooperatives, the foregoing discussion applies with equal force to the organization of an overhead association. If it is to be a thro-going cooperative association, the non-stock law will best serve its purpose; if it is to be a semi-cooperative association and transact business for non-members as well as members, the stock form may have some advantages.

Associations incorporated under the 1915 cooperative law are permitted to subscribe for shares in other cooperative associations. They are, however, permitted to make such investment only out of the reserve fund and in an amount not to exceed 25 percent of their capital. Nothing, however, is said specifically as to how the "other" cooperative association shall be organized, financed and controlled, which raises a question as to whether it was contemplated that this law be used by overhead organizations.

The non-stock law, however, definitely states that federated cooperative associations may be incorporated under it. Membership in such federations is limited to non-stock cooperative associations. Each member association shall have one vote and shall be represented in the central association by a delegate chosen by the local board of directors. In all other respects the central would be subject to the same provisions of this law as local associations incorporated under it.

No single plan of organization or financing can be regarded as best under all circumstances and the foregoing should be regarded merely as suggestive. Local conditions in individual cases may justify wide departures from the above. The cooperative stock law of 1915 has wide application and makes possible a realization of many if not most of the benefits of cooperation. In view of the fact that many associations are still endeavoring to cooperate under the ordinary corporation law, there are many opportunities for realizing more fully the purposes of cooperation by reorganizing under this law.

Many communities, however, will find that the 1921 law conforms more nearly to their cooperative idea. The fuller protection it affords to those who desire to adopt a thoro-going cooperative plan should not be overlooked. Such communities will not be content with the limitations of a plan based on a modified form of ordinary corporation law, but will favor the more complete elimination of the capitalistic features, the more equitable sharing of benefits and responsibilities, the more complete control of the membership, and the greater emphasis upon service embodied in organization under the 1921 non-stock, non-profit law.

COOPERATIVE ASSOCIATIONS AND THE INCOME TAX

It has always been held by cooperators that since profit-making is not the purpose of cooperative associations, they should not be subject to the payment of income taxes. Associations whose proprietary interest has benefited unduly, however, have usually had difficulty in justifying such exemption.

Farmers' mutual companies, or buying or selling agencies of a purely local character "the income of which consists solely of assessments, dues and fees collected from members for the sole purpose of meeting expenses," or turning back to them the proceeds above expenses on a patronage basis, or operating strictly upon a cost basis, are exempt from income taxes.

Quoting extracts from Article 522 of the Treasury Department regulations we learn that:

"If the proceeds of the business are distributed in any other way than on such a proportionate basis, or if the association deducts more than necessary selling expenses, it does not meet the requirements of the statute and is not exempt. The maintenance of a reasonable reserve for depreciation or possible losses of a corporation organized to act as sales agent for farmers and having a capital stock on which it pays a fixed dividend amounting to the legal rate of interest, all of the capital stock being owned by such farmers, will not for that reason be denied exemption. * * * In order to be exempt an association must establish that it has no net income for its own account. An association acting both as a sales and a purchasing agent is exempt if as to each of its functions it meets the requirements of the statute."

Bulletin No. 1106 of the U. S. Department of Agriculture adds:

"If a cooperative association, otherwise exempt, deals with non-members on the same terms as members, including the payment to non-members of patronage dividends on the same terms as members, it is exempt from Federal income taxes."

It will be noted that associations are not automatically exempted from income tax payments merely by virtue of their form of organization. It must be shown that they have actually operated in accordance with the cooperative purpose as interpreted in the foregoing quotations. It will be apparent that associations incorporated under the 1921 law more nearly fulfill all of the conditions necessary to secure exemption than those incorporated under the 1915 law. The latter will ordinarily be subject to the payment of income taxes on any profits earned on non-member business as well as on member business which have not been prorated back to them on a uniform patronage basis. That the taxable status of each association is decided strictly upon its own merits and that if once held exempt it does not necessarily hold good for all time, is further emphasized in the following quotation from the regulations referred to:

"Proof of exemption: In order to establish its exemption and thus be relieved of the duty of filing returns of income and paying the tax it is necessary that every organization claiming exemption, except personal service corporations, file an affidavit with the collector of the district in which it is located, showing the character of the organization, the purpose for which it was organized, the sources of its income and its disposition, whether or not any of its income is credited to surplus or may inure to the benefit of any private stockholder or individual, and in general all facts relating to its operations which affect its right to exemption. To such an affidavit should be attached a copy of the charter of articles of incorporation and by-laws of the organization. Upon receipt of the affidavit and other papers by the collector he will inform the organization whether or not it is exempt. If, however, the collector is in doubt as to the taxable status of the organization he will refer the affidavit and accompanying papers to the commissioner for decision. When an organization has established its right to exemption it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations, or the purpose for which it was originally created. Collectors will keep a list of all exempt corporations to the end that they may occasionally inquire into their status and ascertain whether or not they are observing the conditions under which their exemption is predicated."

As the income tax regulations and rulings are being modified from time to time cooperative associations should avail themselves of the income tax and auditing service maintained by such organizations as the Farmers' Grain Dealers Association of Iowa, the Iowa Cooperative Livestock Shippers and other similar organizations.

CHANGING THE FORM OF ORGANIZATION

The procedure involved in incorporating is the same under the cooperative laws as under the ordinary corporation law, except that the fee for filing the articles under the 1915 law is \$10.00, and under the 1921 law is \$5.00. However, if the capital stock of an association incorporating under the 1915 law is less than \$500.00 the fee is only one dollar.

A method of changing existing associations to the cooperative plan is provided for under both of the cooperative laws. The 1921 law regarding this point reads as follows:

"Sec. 16. All corporations, or associations heretofore organized and doing business under prior statutes, or which have attempted so to organize and do business cooperatively, shall have the benefit of all the provisions of this act and be bound thereby, on filing with the secretary of state a written declaration signed and sworn to by the president or the secretary, to the effect that said company or association has, by a majority vote of

its stockholders, decided to accept the benefits of and to be bound by the provisions of this act."

This method may be feasible where no objection is raised to the change. However, there is some probability that such a disposition of the interests of the stockholders may properly be objected to by dissenting stockholders. In order to preclude completely the possibility of difficulties arising in the future, it may be more feasible to dissolve the old company, satisfy the legal claims of all stockholders, and organize a new company. The organization procedure in such cases would be the same as though no previous organization had existed. A number of points, however, will need to be considered in connection with the dissolution of the old company and the disposition or transfer to the new company of the assets of the old company.

DISSOLVING THE OLD COMPANY

The law states that a corporation may be dissolved before the expiration of its charter by unanimous consent, or in accordance with the provisions of its articles. Where the articles provide for such dissolution, all that is required is the passage of a motion or resolution favoring the dissolution. In the absence of provisions in the articles for dissolution, unanimous consent would be necessary. This, it is often difficult to secure. If unanimous consent cannot be secured, the interest of dissenting stockholders can sometimes be bought by the company or by other members. For the sake of harmony in the community, arbitrary methods are not to be strongly urged. In most cases dissenting members may be made to realize that a fair settlement is preferable to holding out against the wishes of the community or to the possible alternative of a new company being organized anyway and the old one abandoned.

In most cases a large majority of the members will be willing to transfer their proprietary interest to the new company, in which case shares in the new company in case of stock associations, may be issued to such members in settlement of their interest in the old company. In the case of non-stock associations, certificates of indebtedness may be issued instead of stock. The interest of those not desiring to continue their membership in the new company would be settled in cash. However, in the case of non-stock associations, it would be perfectly proper to issue certificates of indebtedness to any retiring members who might be willing to transfer their interest to the new company on a loan basis. If it is not desired to issue stock in the new company to the full amount of the capital stock and surplus of the old company, the difference could be paid in cash or notes, or it could be carried over as surplus to the new association, in which case new shares to new members would need to be priced at the book value of the old shares.

Adjustments may need to be made to equalize the financial burden among the members or because the interest of some members in the old company may be greater than is permitted under the 1915 law or than may be desirable under the 1921 law.

The assets of the old company would be assigned to the new association which would also assume the liabilities. The new association cannot then be made defendant in any action which might subsequently be brought by a dissenting stockholder or by those who may subsequently become creditors. Notice of dissolution, however, must be published for the same time and in the same manner as required for organization. The old company then becomes legally extinct upon application to the secretary of state for permission to surrender its charter.